# THE NEGOTIABLE INSTRUMENTS LAW — NECESSARY AMENDMENTS.

THE Negotiable Instruments Law has been enacted in twenty states and the District of Columbia. There is reason to believe that it would have been adopted in some other states but for the criticisms of several of its provisions in earlier numbers of this REVIEW.[1] In the American Law Register for August, September, and October there is a series of articles by Mr. Charles L. McKeehan upon "The Negotiable Instruments Law — A Review of the Ames-Brewster Controversy."[2] Whether readers agree or disagree with the reviewer's conclusions, all must recognize his ability, impartiality, and knowledge of his subject. This year most of the biennial legislatures meet, and attempts will be made to secure the enactment of the new code in additional states. It is quite possible that attempts will also be made to amend the Law in some states which have adopted it.

It is not the object of this paper to reiterate in detail former criticisms upon the new code. But, inasmuch as the reviewer of the Ames-Brewster controversy sustains the greater part of these criticisms,[3] it seems worth while to point out that the most serious defects in the new code are in those sections in which the codifiers departed from the model of the English Act, and to call attention to two sections in which the defects, though common to both Acts,

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[1] 14 HARV. L. REV. 241, 442; 15 HARV. L. REV. 26. These criticisms and the replies thereto by Judge Brewster in 10 Yale L. J. 84; 15 HARV. L. REV. 26 together with a letter from Mr. Arthur Cohen, Q. C., to Judge Brewster, and the text of the Negotiable Instruments Law have been published in a pamphlet by the Harvard Law Review Publishing Association.

[2] 41 Am. L. Reg. 3, 499, 561.

[3] It is right to say that Mr. McKeehan has convinced the writer that his first objection to § 49 is fully met by the suggestion that the indorsement required of the transferor might in certain cases be a qualified indorsement. If the American courts would follow the Scotch precedent of Hood *v.* Stuart (Court of Sess. March 20, 1870) in which case the assignee of the accommodated payee was allowed without the aid of the latter's indorsement to charge the accommodating acceptor, his second objection to that section would disappear also. He must dissent, however, from Mr. McKeehan's view that the case of accommodation and the case of fraud are to be treated in the same manner. The reason for the distinction is clearly pointed out in the Scotch case.

not only change well-established American law, but also threaten serious injustice.

The sections that would be wisely amended by making them uniform with the English Act are eight, namely, 20, 40, 65–4, 119–4, 120–3, 120–5, 120–6, and 137. The other two are sections 124 and 186.

SECTION 20 makes an agent, who signs his principal's name without authority, liable on the instrument. The decisions and text writers are almost unanimous against this doctrine,[1] which arbitrarily imposes upon the parties a contract which was not in the contemplation of anybody. It may work, too, very unjustly. It is right that the agent should be held to warrant his authority to act as agent, and made to answer to the other party for damages suffered by reason of his not getting the principal's obligation. But to make the ostensible agent liable for the face of the instrument, when the contemplated principal was insolvent, would give the holder unjust enrichment and impose an undeserved penalty upon such agent.[2] To amend this section, strike out in the fourth line the words "if he was duly authorized."

SECTION 40. Section 8–3 of the English Act, of which Sections 9–1 and 9–5 are a reproduction, was intended to supersede the doctrine of Smith *v.* Clarke,[3] by which an instrument indorsed in blank continued negotiable although subsequently indorsed specially.[4] But Section 40 revives Smith *v.* Clarke by enacting that "where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery." Mr. McKeehan endeavors to save this section by reading into it before the

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[1] Hall *v.* Crandall, 29 Cal. 567; Lander *v.* Castro, 43 Cal. 497; Taylor *v.* Shelton, 30 Conn. 122; Duncan *v.* Niles, 32 Ill. 532; Seeberger *v.* McCormick, 178 Ill. 404, 417; Thilmany *v.* Iowa Co., 108 Iowa 357, 363; Noyes *v.* Loring, 55 Me. 408; Bartlett *v.* Tucker, 104 Mass. 336; Sheffield *v.* Ladue, 16 Minn. 388; Cole *v.* O'Brien, 32 Neb. 68; Patterson *v.* Lippincott, 47 N. J. Law 457, 459; White *v.* Madison, 26 N. Y. 117; Miller *v.* Reynolds, 92 Hun 400; Delius *v.* Cawthorn, 2 Dev. 90; Bryson *v.* Lucas, 84 N. C. 680, 683; Trust Co. *v.* Floyd, 47 Oh. St. 525; Hopkins *v.* Mehaffy, 11 S. & R. 126 (semble); Story, Ag. (9th ed.) § 764 a; Mechem, Ag. § 550; Huffcut, Ag. § 230; Reinhard, Ag. § 307.

In two or three states an agent who without authority signs 'A. B. agent for C. D.' is held liable on the instrument, everything after his own signature being ignored. Byas *v.* Doores, 20 Mo. 284; Weare *v.* Gove, 44 N. H. 196. But no case has been found in which A. B. signing simply the name of 'C. D.' was charged on the instrument.

[2] Re Nat. Co., 24 Ch. Div. 367, 372, 375.

[3] Peake, 225.

[4] Chalmers, Bills of Exch. Act (5th ed.) 24; Mr. Cohen's letter, 15 HARV. L. REV. 37.

word "payable" the word "originally."[1] But this is inadmissible. Instruments payable to bearer are defined with great care in Section 9 as including several species of instruments. Wherever the generic term is used without qualification in another section, it cannot be limited to one of the species.[2] Furthermore, Mr. Crawford, the draughtsman of the new code, in his note to Section 40 cites Smith *v.* Clarke as if still law. So do the other commentators upon the Act.[3] Mr. McKeehan's suggestion is also opposed to the interpretation given to this section by Judge Brewster, the Chairman of the Committee on Uniform Laws. Section 40 should be expunged.

SECTION 65–4 introduces the novel distinction that a transferor by delivery is a warrantor of title and genuineness only to his immediate transferee while the similar warranty of the indorser without recourse runs to all subsequent holders. There is no authority for this arbitrary distinction.[4] The only decision on the point is against this distinction.[5]

Another new and unfortunate distinction is introduced by subsection 4, by which the transferor of an instrument void for usury is not liable as a warrantor, unless he was aware of the usury, whereas the transferor of an instrument void for coverture or voidable for infancy is liable as a warrantor, although he was ignorant of the coverture or infancy. This distinction is due to the anomalous

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[1] 41 Am. L. Reg. 461.

[2] Section 9–1 reads: "The instrument is payable to bearer when it is expressed to be so payable." Mr. McKeehan understands this section to mean only instruments originally payable to bearer. Such was formerly the opinion of the writer. 14 HARV. L. REV. 246. But clearly it must apply to an instrument originally payable to order and indorsed by the payee expressly "Pay to bearer." Whether, therefore, an instrument is payable to bearer under each of the paragraphs of Section 9 would seem to depend upon the form of the instrument, not at the time of its creation, but at the moment of inspection. An instrument originally payable to order may become payable to bearer by an indorsement to bearer or by an indorsement in blank, and conversely an instrument originally payable to bearer may cease to be so payable by a special indorsement.

[3] Norton, Bills & Notes (Tiffany's ed.) 116; Huffcut, Neg. Inst. 24; 17 Bank. L. J. 12 and 775; Selover, N. I. L. 189 n. 78, citing cases like Smith *v.* Clarke.

[4] The New York cases cited by Mr. McKeehan in 41 Am. L. Reg. 567, n. 12, in which an indorser without recourse was held to be incompetent to testify in an action by a remote holder against the maker, lend no support, it is submitted, to the notion that such an indorser was liable to the remote holder. He was incompetent even if not liable directly to the plaintiff, for if the plaintiff failed to charge the maker, he might proceed against his transferor, and the latter against his predecessor, and so ultimately the indorser without recourse might be sued by his immediate transferee.

[5] Watson *v.* Chesire, 18 Iowa 202.

decision in Littauer *v.* Goldman,[1] and the anomaly, already condemned in other jurisdictions,[2] should not be perpetuated in the Negotiable Instruments Law. In one class of cases the transferor's warranty is rightly limited by his knowledge of the facts at the time of transfer. If the instrument is not collectible by reason of the insolvency of prior parties, he warrants only his ignorance of such insolvency.[3] Section 65 should be amended so as to read as follows:

"Every person negotiating an instrument by delivery merely, or by indorsement, with or without qualification, warrants to his immediate transferee,

"1. That the instrument is genuine and in all respects what it purports to be.

"2. That he has a good title to it.

"3. That it is subject to no real defense, and, if the transfer is after maturity, that it is subject to no personal defense, in favor of any party to the instrument.

"4. That he has no knowledge of any fact which impairs its collectibility."[4]

Because of the amendment of Section 65, Section 66 should also be amended by cancelling everything after "qualification" in the first line to "engages" in the sixth line.

SECTION 119–3 provides that a negotiable instrument is discharged "by any other act which will discharge a simple contract for the payment of money." The acceptance of a chattel in satisfaction of an unmatured simple contract claim discharges it. Therefore such a satisfaction of a note before maturity must, according to this provision, discharge the note. This is a startling innovation, and doubtless to no one more surprising than to the framers of the Act. Mr. McKeehan recognizes the justice of the criticism upon this section.[5] The provision should be cancelled. It would be useless even if it were not mischievous.

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[1] 72 N. Y. 506.

[2] Wood *v.* Sheldon, 42 N. J. Law 421, 424; Meyer *v.* Richardson, 163 U. S. 385, 411, 412.

[3] Cases cited in Chalmers, Bills of Exch. Act (5th ed.) 195, n. 1. See also Gordon *v.* Irvine, 105 Ga. 144; Brown *v.* Montgomery, 20 N. Y. 287 (seller of post-dated check knew that another check of drawer had just been dishonored).

[4] The words "impairs its collectibility" seem to be preferable to "render it valueless," the words of the Negotiable Instruments Law. The warranty should attach, if the instrument is worth fifty cents on the dollar. But such an instrument is not valueless.

[5] 41 Am. L. Reg. 573.

SECTION 120–3. "A person secondarily liable on the instrument is discharged: — By the discharge of a prior party." If the word "discharge" is to receive its natural interpretation, standing as it does without any qualification, it must mean any kind of discharge whether by act of the parties or by operation of law. One secondarily liable would be discharged, therefore, if any prior party should be discharged by the Statute of Limitations, or if any prior indorser should be discharged by the holder's failure to give him due notice of dishonor, and, in jurisdictions where joint obligations are not made joint and several by statute, the death of a surety co-maker would discharge all subsequent parties. A provision producing such results is a legal monstrosity. The defenders of this sub-section say that it applies only to a discharge by act of the parties. But Mr. Crawford in his note to this provision states that an indorser is discharged if the claim against the maker is barred by the Statute of Limitations.[1] The same view is advanced by the commentator in the Banking Law Journal.[2] If a holder appoints an indorser his executor, the law, regardless of the intention of the parties, discharges all subsequent indorsers.[3] Is this a discharge by operation of law or by the act of the parties?

But even if the operation of the sub-section is limited to a discharge by the parties, it is mischievous. It would discharge the accommodated indorser if the holder, with knowledge of the accommodation, should release the accommodating maker. Judge Brewster concedes this. All possible mischief would be avoided and no loss suffered by cancelling this sub-section.

SECTIONS 120–5 and 120–6. No elasticity of interpretation can correct the errors of these sub-sections.[4] They declare in effect that a release or the giving of time to an accommodation acceptor or maker will discharge the accommodated drawer or indorser, and thereby overturn well-established doctrines of Surety-

[1] Crawf. Ann. N. I. L. (2d ed.) 108. It appears from this note that this sub-section was inserted to bring about this very result.

[2] 19 Bank. L. J. 402.

[3] Jenkins *v.* Mackenzie, 6 Up. Can. Q. B. 544; 4 Am. & Eng. Enc. of Law (2d ed.) 506, n. 6.

[4] It has been suggested that "principal debtor" in Section 120–5 may not be synonymous with "party primarily liable." But as the "principal debtor" is contrasted with the "party secondarily liable" the words must be used in the sense of "party primarily liable." Obviously the release in Sub-Section 5 and the giving of time in Sub-Section 6, in which the words "principal debtor" do not occur, are intended to have the same operation. See Mr. McKeehan's observations in 41 Am. L. Reg.

ship. These inaccurate statements of the law of Suretyship should be eliminated.

SECTION 137, treating a destruction or a withholding of a bill by the drawee as an acceptance, is worse than the writer at first supposed. He criticised it as objectionable in point of form. Mr. Cohen, in his letter to Judge Brewster,[1] and Mr. McKeehan [2] have made it clear that the section is erroneous in principle. If the drawee of a three months bill presented to him for acceptance should, in a fit of anger at the drawer's presumption in drawing upon him, refuse to accept it and throw it in the fire, the holder, under this section, would have no remedy on the instrument against the drawer either on the bill or for the consideration for which the bill was given until after its dishonor by non-payment. As Mr. Cohen says: "This is not in my opinion the law, and ought not to be the law." This section should be expunged.[3]

Each of the amendments thus far recommended would remove a difference between the English and American codes. It remains to consider two sections whose amendments would introduce a difference between the two codes.

SECTION 124. By the English decisions a material alteration of an instrument, even by a stranger, nullified it. The American courts, deeming the English precedents repugnant to justice, declined to follow them, and decided that the holder should not forfeit his rights because of this wrongful act of a stranger. The Bills of Exchange Act codified the English decisions. The Negotiable Instruments Law, instead of codifying the American decisions, abandoned them, and restored the medieval doctrine of forfeiture. Other things being equal, uniformity between the American and English law is to be encouraged. But where it is a choice between uniformity and justice, American legislators ought not to hesitate to sacrifice uniformity. Upon the point of justice in this case the words of Mr. Justice Story may be cited: "The old cases proceeded upon a very narrow ground. It seems to have been held, that a material alteration of a deed by a stranger, without the privity of either obligor or obligee avoided the deed;

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[1] 15 HARV. L. REV. 38.

[2] 41 Am. L. Reg. 583.

[3] This section is objectionable for another reason. A drawee, who destroys the instrument, is properly liable to the holder for its collectible value, as in any case of conversion of a bill. But the fictitious acceptor, under this section, must pay the payee the face value of the bill, although the drawer is hopelessly insolvent.

and by parity of reasoning the destruction or tearing off the seal either by a stranger or by accident. A doctrine so repugnant to common sense and justice, which inflicts on an innocent party all the losses occasioned by mistake, by accident, by the wrongful acts of third persons, or by the providence of Heaven, ought to have the unequivocal support of unbroken authority, before a Court of law is bound to surrender its judgment to what deserves no better name than a technical quibble."[1] The section should be amended by adding after the word "altered" in the first line the words "by the holder." It is believed that it would be advisable also to insert before the word "materially" in the first line the words "fraudulently and."

SECTION 186 together with Section 89 provides that the drawer of a check is absolutely discharged by the holder's failure to give him due notice of its dishonor although the laches has not caused any loss to him. This section changes well settled law, and for the worse. Fortunately cases presenting the facts here supposed are not likely to be frequent. But this will be small consolation to the particular plaintiff when the case does arise.

To sum up, Sections 20, 65–4, 119–4, 120–3, 120–5, 120–6, and 137 are obnoxious to these three objections. They introduce unnecessary distinctions between the English and American codes. They nullify generally established and well-approved doctrines of the American and English courts. They are sure to provoke needless litigation and to cause much injustice.

Section 40 is open to the first and third objections, and furthermore nullifies the wholesome innovation of Section 9–5.

Section 186 is opposed to the American and English precedents and is doubtless due to an inadvertence of the American and English codifiers.

Section 124 is a return to archaic formalism, and the language of Judge Story, already quoted, fittingly describes its injustice.

The writer retains his conviction that it is wiser to have no code at all than to adopt the Negotiable Instruments Law in its present form. If, on the other hand, this law should be amended as suggested in this paper, the sooner it is enacted throughout the Union, the better.

*J. B. Ames.*

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[1] U. S. *v.* Spalding, 2 Mas. 478, 482. See the similar remarks by Beasley, C. J., in Hunt *v.* Gray, 35 N. J. Law 227, 233.